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FISCAL IMPACT STATEMENT

LS 6344

BILL NUMBER: HB 1001

NOTE PREPARED: Mar 16, 2006

BILL AMENDED: Mar 14, 2006

SUBJECT: Various Tax Matters.

FIRST AUTHOR: Rep. Espich

FIRST SPONSOR: Sen. Kenley

BILL STATUS: Enrolled

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Homestead Credit:* This bill increases the homestead credit (HSC) for one year in 2006 to 28% and makes an appropriation for the additional HSC amount. The bill also provides an additional distribution in 2006 to reimburse counties that send out revised tax bills to implement the additional HSC. In addition, the bill permits homestead credits to be certified using the best information available at the time the certification is made.

Standard Homestead Deduction: The bill increases the homestead standard deduction for one year to \$45,000 for taxes payable in 2007.

Taxpayer Notifications: Beginning in 2008, this bill requires counties to use a uniform format for property tax statements that includes additional taxpayer information. Beginning in August 2009, the bill also requires counties to mail notices concerning budget proceedings and proposed tax rates, tax levies, and budgets to each taxpayer and permits taxpayers to appeal their assessments within 45 days after getting the notice.

Petition and Remonstrances: This bill limits use of students and teachers in promoting a bond issue; prohibits attorneys, architects, construction managers, and financial advisors from contributing money to promote a bond issue; and provides standards for accepting signatures on a remonstrance petition.

Credit for Excessive Residential Property Tax: The bill extends the time in 2006 in which a county fiscal body may adopt an ordinance to provide taxpayers with a cap on residential property taxes equal to 2% of the assessed value of the residential property. Beginning in 2007 for Lake County and 2008 for all other counties, the bill establishes a 2% cap without a county fiscal body ordinance. The bill also extends the 2% cap to all

property in 2010.

Utility Services User Tax: This bill imposes a Utility Use Tax in transactions on which a Utility Receipts Tax has not been imposed.

LIHEAP Sales Tax Exemption: The bill exempts home energy assistance from Gross Receipts Tax (Sales Tax) for one year.

Other Sales and Use Tax Provisions: This bill prohibits the assignment of Sales Tax remittance deductions to nonaffiliated companies. It indicates that property constructed outside Indiana for Indiana use is subject to Use Tax.

Corporate Adjusted Gross Income (AGI) Tax Add Back: This bill requires certain intangibles expenses and directly related intangible interest expense deducted for federal income tax purposes to be added back to a corporation's taxable income for state Adjusted Gross Income Tax purposes.

Single-Sales-Factor Apportionment: The bill provides after a phase-in period that corporate business income is apportioned to Indiana for Adjusted Gross Income Tax purposes using a single sales factor. It indicates how the freight on board location of a sale affects the apportionment formula.

Other Corporate Tax Provisions: This bill requires a corporation that files combined income tax returns to petition the Department of State Revenue for permission to discontinue filing combined returns.

Jasper County CAGIT: The bill permits an additional County Adjusted Gross Income Tax (CAGIT) rate in Jasper County

Scott County COIT: The bill permits an additional County Option Income Tax (COIT) rate in Scott County to construct and maintain criminal justice facilities.

Adoption of CEDIT for Homestead Credits: This bill extends the time in 2006 during which an additional County Economic Development Income Tax (CEDIT) rate may be imposed to provide property tax relief to mitigate the effects of the elimination of the property tax on inventory.

County Residential Tax Relief: The bill permits a county to provide tax relief to other residential property in addition to homesteads in order to mitigate the increase in property taxes resulting from the statewide deduction of inventory.

Dog Tax: This bill replaces the requirement that a dog tax be imposed in each county with a county option dog tax. It makes a technical correction.

Tuition Support: The bill increases the calendar year cap on tuition support distributions for the calendar year ending December 31, 2006, by \$48.2 M or the amount needed to avoid reducing distributions in the second six months of the calendar year. It changes the school funding formula to eliminate the effects of annual property tax assessed value adjustments. The bill appropriates \$20.1 M or the amount needed for state tuition support distributions in the state fiscal year ending June 30, 2006. It makes other related changes.

Farm Mutual Insurance Companies: This bill provides that a farm mutual insurance company may elect

taxation under the Gross Premium Tax instead of the Adjusted Gross Income Tax.

Study for a State Employee Retirement Health Plan: The bill directs the Office of Management and Budget to develop a proposal for presentation to the State Budget Committee by November 1, 2006, concerning an actuarially funded retirement health program for state employees.

Effective Date: July 1, 2005 (retroactive); January 1, 2006 (retroactive); Upon passage; July 1, 2006; January 1, 2007.

Explanation of State Expenditures: PTRC / HSC Background: The state currently pays PTRC in the amount of 60% of school general fund levies attributable to all property and 20% of the portion of all operating levies (including the remaining 40% of the school GF levy) that are attributable to real property and non-business personal property. Homestead Credits are paid by the state in the amount of 20% of the net property tax due for qualifying funds on owner-occupied residences. The amount paid is subject to appropriation.

Homestead Credit: Under this provision, the state would pay an additional 8% HSC to homeowners in CY 2006, bringing the total HSC rate to 28%. The HSC rate would revert to 20% for taxes payable in 2007.

The bill provides for a distribution from the Property Tax Replacement Fund (PTRF) to pay for the credit. This distribution would not be subject to the current PTRF appropriation limits that apply to the existing HSC and PTRC. The bill allows augmentation of the current appropriation to pay the additional credit, so this credit would ultimately be paid from the General Fund.

The bill would allow county auditors to apply the entire credit to the November 2006 tax installment if payment of half of the credit against the May 2006 installment would delay tax bill mailing by more than 30 days.

The estimated cost of the credit is \$98.2 M in CY 2006, or \$32.8 M in FY 2006 and \$65.4 M in FY 2007. Depending on the timing of the credit payments locally, a larger portion of the CY 2006 credit could be paid by the state in FY 2007.

In addition, the bill provides that the state will pay counties up to \$1.00 for each revised tax statement that the county would have to send out if tax billings have already been sent or will be sent before the additional credit is added. There are just over 1.5 million homesteads in the state. The maximum amount that the state could have to pay to the counties to produce revised tax statements is estimated at \$1.5 M. However, as of March 15, 2006, only 77 out of 92 counties had certified tax rates with 20 of those counties being certified within the last week. It is understood that only a handful of the counties with certified tax rates have sent tax bills. So, the actual state expense for revised tax statements would be much smaller than the \$1.5 M maximum.

Standard Homestead Deduction: The shift of property taxes from homesteads to other types of property will cause a reduction in the state's full liability for PTRC and HSC but it will not affect the amount paid under the appropriation limit.

The current state budget, HEA 1001 (2005), appropriated \$2,028.5 M for each year of the FY 2006/FY 2007 biennium to pay PTRC/HSC expenses. If the PTRC and HSC rates generate a liability in a year that is greater than the appropriation, then the Department of Local Government Finance (DLGF) must proportionately reduce the 60% school general fund, 20% regular PTRC, and 20% HSC percentages.

It is estimated that under current law the state's full liability for PTRC/HSC would exceed the FY 2007 appropriation by about \$55.9 M. The excess liability will require the DLGF to reduce the credit percentages for all of CY 2007, not just the part of CY 2007 that falls within FY 2007. The total CY 2007 PTRC/HSC reduction is currently estimated at \$167.3 M.

The increase in the standard deduction amount would reduce homestead property taxes and would reduce the amount by which the full payment in FY 2007 would exceed the appropriation from \$55.9 M down to \$49.4 M. The estimated total CY 2007 PTRC/HSC reduction under this provision would change from \$167.3 M to \$147.9 M. Actual state expenditures would be unchanged by this provision.

Taxpayer Notifications - Tax Bills: Under this provision, the DLGF, subject to State Board of Accounts approval, would prescribe the form of the property tax statement to be used by county treasurers beginning in 2008. Current law contains a pilot program in selected counties that will become a statewide requirement in 2008 to provide additional statement information to all taxpayers. Currently, the state may reimburse each county for printing, mailing, and initial programming costs directly related to the new statements. The overall total reimbursement that may be paid for all counties is limited to \$50,000. This provision deletes the reimbursement language.

Department of State Revenue (DOR): The DOR will have additional administrative tasks and will incur additional expenses to revise tax forms, instructions, and computer programs due to the provisions of this bill concerning the following:

- Farm mutual insurance company tax treatment
- LIHEAP Sales Tax exemption
- Single-sales-factor apportionment
- Sales and Use Tax changes (bad debt assignment and use tax imposition)
- Corporate add-back for certain intangible expenses deducted for federal income tax purposes
- Utility Services User Tax

Certification of Additional Local Option Rates: The Department of State Revenue and the State Budget Agency would be required to adjust Scott County's COIT and Jasper County's CAGIT certified distribution for the year following a tax rate increase authorized under the bill. The Department and the Budget Agency should be able to carry out this provision within their existing resources.

Any overpayments of the distribution due to local option tax rate increases would be covered by the state General Fund until adjusted in the subsequent year distributions.

Dog Tax: The bill repeals provisions that provide for the Dog Tax. The bill also provides that if any money remains in the State Dog Account of the state General Fund on June 30, 2006, the Auditor of State must on January 1, 2006, abolish the account and distribute 50% of the money to Purdue University for the School of Veterinary Science and Medicine and 50% to counties that paid surplus money into the account. As of February 21, 2006, the State Dog Fund had a balance of \$48,864.

County Option Dog Tax Form: The bill requires the DLGF to prescribe a county option dog tax return form. The DLGF should be able to do so within its existing level of resources.

Tuition Support: The bill increases the 2006 calendar year cap on state tuition support distributions. It also

increases the state fiscal year appropriation for state tuition support distributions for state FY 2006.

Study for a State Employee Retirement Health Plan: The bill provides that the Office of Management and Budget (OMB) is to study and develop a proposal under which the state and state employees may make monetary contributions to a health savings account, a deferred compensation account, or another tax advantaged savings program with a goal of actuarially pre-funding a major portion of the expected retirement health care premium costs of state employees. The bill specifies certain elements for consideration and inclusion in the proposal. The OMB is to present the proposal to the State Budget Committee by November 1, 2006. The OMB should be able to conduct this study and develop a proposal within their existing level of budget and resources.

Explanation of State Revenues: Utility Services User Tax: This bill creates a Utility Services User Tax (USUT) which is imposed on a person that uses or consumes utility services received from an out-of-state provider. The person liable for the tax shall pay the tax to the provider, and the provider shall remit the tax to the state. The tax rate is the same rate as the Utility Receipts Tax (URT), or 1.4%. The tax is effective July 1, 2006. DOR shall establish procedures for the collection of the use tax and may require providers to register with the Department. The same exemptions to the URT apply to the USUT. According to DOR, there are currently a few out-of-state utility providers who are supplying services to Indiana companies and are not subject to the URT. This USUT will bring in an indeterminable amount of revenue beginning in FY 2007.

LIHEAP Sales Tax Exemption: This bill provides a one-year Sales Tax exemption for sales of home energy involving:

- (1) a person who is acquiring the energy through a home energy assistance program administered by the Division of Family Resources (DFR);
- (2) electrical energy, natural or artificial gas, water, steam, or steam heating service; and
- (3) energy which is acquired after June 30, 2006, and before July 1, 2007.

Creating a Sales Tax exemption for these home energy sales is expected to reduce state Sales Tax revenue by approximately \$2.24 M in FY 2007. However, it should be noted that the extent of this reduction will depend in large part on the federal appropriations for the Low-Income Heating and Energy Assistance Program (LIHEAP). Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%). A \$2.24 M reduction in Sales Tax revenue would reduce FY 2007 distributions to these funds by the following amounts.

Fund	Reduction
Property Tax Replacement Fund	\$ 1,120,000
State General Fund	1,101,901
Public Mass Transportation Fund	14,224
Commuter Rail Service Fund	3,136
Industrial Rail Service Fund	739
Total	\$ 2,240,000

Background: General Fund money is not used to support the energy assistance programs administered by the Division of Family Resources. Funding for the state's energy assistance program comes from federal

sources and dedicated state funds.

Since the early 1980s, the federal government has annually appropriated funds to states to provide energy assistance to low-income families. Indiana's program is divided into two components: the Energy Assistance Program (EAP) and the Weatherization Assistance Program (WAP). The program is primarily funded through the federal LIHEAP block grant. In accordance with federal guidelines, the state uses about 90% of the federal appropriation for energy assistance programs, and the remaining funds for weatherization programs. These programs also receive funds from the state's dedicated Oil Overcharge Accounts. These accounts were funded by settlements between the federal government and oil companies.

The state's energy assistance program provides grants for winter heating assistance and summer cooling assistance. Additionally, the program provides eligible persons with a one-time credit, as necessary, to prevent heat from becoming disconnected. Indiana's program currently provides assistance to persons within 125% of the federal poverty guidelines.

Energy assistance funds are distributed through a statewide network of 24 Community Action Agencies (CAA). In accordance with federal law, CAAs and the state retain a percentage of the federal grant money to cover administrative costs.

Over the past three fiscal years, federal LIHEAP benefits have provided approximately \$38.7 M in direct benefits to Indiana residents each year. Funding for energy assistance from the Oil Overcharge Accounts has ranged from \$2 M to \$4 M each year. Funding from the Oil Overcharge Accounts is expected to last through FY 2006.

Other Sales and Use Tax Provisions: The fiscal impact of these changes to the Sales and Use Tax is indeterminable. This bill provides that Use Tax is imposed on a person who:

- (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and
- (2) uses, stores, distributes, or consumes tangible personal property in Indiana.

The fiscal impact of this provision is indeterminable. It is estimated that this provision will cause an increase in Use Tax collections.

This bill also provides that for transactions occurring after December 31, 2006, a retail merchant may *NOT* assign the Sales and Use Tax deductions allowed under IC 6-2.5-6-9 to any individual or group that is not part of the same "affiliated group" as the taxpayer assigning the deduction. Affiliated group is defined for purposes of this Sales and Use Tax provision as either of the following.

- (1) An affiliated group within the meaning provided in Section 1504 of the Internal Revenue Code (IRC), except that the ownership percentage in Section 1504(a)(2) of the IRC shall be determined using 50% test rather than 80% test.
- (2) Two or more partnerships, including LLCs and LLPs, that have the same degree of mutual ownership as an affiliated group described in (1).

IC 6-2.5-6-9 allows a retail merchant deductions for transactions:

- (1) where the merchant did not collect Sales or Use Tax from the purchaser;
- (2) where the merchant previously paid Sales or Use Tax on the transaction; and
- (3) which were written off as uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code.

Under current law, these deductions are assignable. The fiscal impact of this provision is indeterminable. Sales and Use Tax collections would only be affected to the extent that a retail merchant who previously would have assigned the deduction could not then apply the deduction to the retailer merchant's own Sales and Use Tax liability.

Corporate AGI Tax Add-Back: The bill establishes an add-back of deductions taken on a corporation's federal income tax return for intangible expenses or certain intangible interest expenses paid, accrued, or incurred by the corporation with one or more members of the same "affiliated group" of corporations or with one or more foreign corporations. The amount of revenue that could potentially be captured due to the add-back is indeterminable and dependent on the number of corporate taxpayers currently conducting these types of transactions with affiliated group members. It is important to note that the magnitude of the fiscal impact also depends on the extent that these taxpayers can establish that they meet criteria (also specified in the bill) that precludes the add-back from applying to them. Since the add-back is effective for taxable years beginning after June 30, 2006, any fiscal impact could commence in FY 2007.

For purposes of this add-back provision, an "affiliated group" is one or more corporations connected through stock ownership with a common parent corporation provided that: (1) the common parent directly owns stock of at least one of the group members comprising at least 50% of the voting power and 50% of the value of that group member; and (2) stock meeting the 50% test in each member other than the common parent must be owned directly by one or more of the other members.

Background: A common example of a related member transaction involves the use of a passive investment company (PIC) to transfer income to a tax haven state that is actually income earned and taxable in Indiana. An Indiana operating company can establish a PIC in a state that does not have a corporate income tax (like Nevada) or that has a special income tax exemption for intangibles (like Delaware). Once the company establishes a PIC in another state, the company can then transfer income ("profits") to the PIC by having the PIC charge a royalty fee to the Indiana company for the use of a trademark, patent, or other type of intangible asset. This reduces the Indiana AGI tax liability of the operating company.

These transactions are further complicated when a PIC loans "profits" back to the operating company, and the operating company can then deduct the loan interest from Indiana AGI, thereby reducing their tax liability. Typically, large multi-state retailers engage in these sorts of transactions. Companies are not required to include payments for intangibles in Indiana adjusted gross income if the company has a location in another country with a comprehensive income tax treaty with the United States.

Single-Sales-Factor Apportionment: The bill provides for a 5-year phaseout (from 2007 to 2011) of the payroll and property factors used to apportion a corporate taxpayer's adjusted gross income to Indiana under the AGI Tax. Beginning in 2011, AGI of corporate taxpayers would be apportioned solely on a single sales factor. Based on taxpayer simulations and the current forecast of corporate revenue collections, the change to single-sales-factor apportionment is estimated to result in a net decrease of revenue from the corporate AGI Tax as outlined in the table below.

Fiscal Impact	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Low Range	(\$2.0 M)	(\$6.1 M)	(\$10.4 M)	(\$14.9 M)	(\$25.3 M)	(\$34.0 M)
High Range	(\$3.1 M)	(\$10.0 M)	(\$17.6 M)	(\$26.2 M)	(\$45.9 M)	(\$63.9 M)

Background: The bill phases out the payroll and property factors for purposes of computing corporate AGI Tax. The apportionment formula is used to determine Indiana adjusted gross income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used including property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double-weighted so that the payroll and property factors combined represent 50% of the apportionment factor, with sales representing the remaining 50%. The current apportionment formula is shown below.

$$\left[\frac{\text{Indiana Property}}{\text{Total Property}} + \frac{\text{Indiana Payroll}}{\text{Total Payroll}} + 2 * \left(\frac{\text{Indiana Sales}}{\text{Total Sales}} \right) \right] \div 4$$

The bill phases out the payroll and property factors by 10% each year from 2007 to 2011. The phaseout schedule is as follows:

	Sales Factor Weight	Combined Weight of Payroll and Property Factors
Current	50%	50%
2007	60%	40%
2008	70%	30%
2009	80%	20%
2010	90%	10%
2011 and after	100%	0%

After the phaseout of the payroll and property factors in 2011, a corporation's income would be allocated to the state based on its Indiana sales as a proportion of its total sales in the United States. The single-sales-factor apportionment formula is presented below:

$$\frac{\text{Indiana Sales}}{\text{Total Sales}}$$

Corporate AGI taxes are distributed to the General Fund. In FY 2005, \$608.4 M was collected in corporate AGI Taxes.

Methodology: The fiscal impact is estimated based on a taxpayer simulation using 2003 Corporate

AGI taxpayer information (from the IT 20 returns) and recalculating tax liabilities based on the changes in the apportionment formula. The revenue estimates above are based on the first year that corporate taxpayers were taxed solely on adjusted gross income and not gross receipts. *The extent to which this change in tax policy will alter the corporate tax base and future revenue collections is unknown.* Based on the simulation, the net revenue loss from moving to single-sales-factor apportionment is not the result of all corporate taxpayers experiencing some decline in tax liability. Rather, it is the additive result of some taxpayers experiencing a decrease in tax liability and others experiencing an increase in tax liability that fails to fully offset the total of the tax reductions. The simulations using 2003 taxpayer data resulted in about 2,300 taxpayers experiencing a decrease in net tax liability after credits and about 4,700 experiencing an increase in net tax liability after credits. The simulations also resulted in nearly 28,500 taxpayers being unaffected by the change to single-sales-factor apportionment.

The low-range estimate is the net impact on tax liabilities assuming that the taxpayers experiencing tax liability increases due to single-sales-factor apportionment would not have additional NOL (net operating loss) deduction amounts or tax credit amounts to reduce these higher tax liabilities. Thus, they would utilize the same NOL deduction amounts and tax credit amounts as reported in 2003. The high range is the net impact assuming that some taxpayers experiencing tax liability increases due to single-sales-factor apportionment will have sufficient additional NOL deduction amounts and tax credits to reduce these higher tax liabilities. *It is important to note that the net revenue loss could potentially exceed the high range if all of the taxpayers experiencing increased liabilities are able to utilize additional NOL deduction amounts or tax credits to reduce these higher tax liabilities to zero.*

The tables below summarize the results of the 2003 taxpayer simulations. The table below shows the extent that single-sales-factor apportionment would have affected 2003 Indiana **apportioned income**. A total of 35,396 taxpayers were used for the simulation, with 7,128, or 20%, experiencing an increase in Indiana apportioned income and 4,034, or 11%, experiencing a decrease in apportioned income. The net effect for these taxpayers was a 6% decrease in Indiana apportioned income. A total of 24,234, or 69%, of all the regular C corporate taxpayers experienced no change in Indiana apportioned income.

Effect of Single-Sales-Factor (SSF) Apportionment on Indiana Apportioned Income - 2003 Tax Data*						
Apportioned Income	# Affected	Apportioned Income - Current	Apportioned Income Under SSF	Difference	% Diff.	Avg. Diff.
Increase	7,128	\$1,703.9 M	\$2,265.0 M	\$561.1 M	33 %	\$78,718
Decrease	4,034	\$2,287.0 M	\$1,473.1 M	(\$813.9 M)	(36%)	(\$201,751)
Total Affected	11,162	\$3,990.9 M	\$3,738.1 M	(\$252.8 M)	(6%)	(\$22,645)
No Change	24,234	\$1,290.9 M	\$1,290.9 M	\$0	0	\$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The next table summarizes the impact that single-sales-factor apportionment would have had on 2003 **net tax liabilities** (after credits) for the same group of corporate taxpayers. The simulations resulted in 4,678, or 13%, of the taxpayers experiencing a tax increase and 2,309, or 7%, of the taxpayers experiencing a tax decrease. The net decrease in tax liability for all affected taxpayers would have been about 4%. A total of 28,409, or

80%, of the regular C corporate taxpayers would have experienced no change in net tax liability after credits.

Effect of Single-Sales-Factor (SSF) Apportionment on Net Tax Liability After Credits - 2003 Tax Data*							
Tax Liability	# Affected	# of Payers	Current Tax	Tax Under SSF	Difference	% Diff.	Avg. Diff.
Increase	4,678	3,950	\$116.0 M	\$163.6 M	\$47.6 M	41%	\$10,683
Decrease	2,309	2,136	\$156.9 M	\$99.5 M	(\$57.4 M)	(37%)	(\$13,473)
Total Affected	6,907	6,086	\$272.9 M	\$263.1 M	(\$9.8 M)	(4%)	(\$6,568)
No Change	28,409	8,819	\$87.2 M	\$87.2 M	\$0	0	\$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The last table shows the shift in the share of AGI taxes that would have been paid in 2003 by the three groups of corporations. The simulation results indicate that the share of taxes paid by taxpayers experiencing an increase in liability goes from 32% to 47%. The share for corporations experiencing a reduction in tax liability falls from 44% to 28% of the total.

Taxpayers who's taxes...	% Share under Current Law	% Share under Single Sales
Increase	32%	47%
Decrease	44%	28%
are Unaffected	24%	25%

Other Corporate Tax Provisions: The bill contains a provision which clarifies that when property is delivered or shipped to an Indiana resident, regardless of the f.o.b. designation, or other conditions of a sale, the company making the sale is required to attribute that sale to the numerator of the company's sales factor for corporate AGI Tax purposes. The bill also requires a corporation that files combined Income Tax returns to petition the Department of State Revenue for permission to discontinue filing combined returns. Neither of these provisions is expected to have a fiscal impact.

Dog Tax: The bill establishes a state Special Canine Research and Education Account within the state General Fund. Money deposited in a county canine research and education account would be deposited into the state Special Canine Research and Education Account semi-annually. Income earned or money held in the state Special Canine Research and Education Account becomes a part of the account. Revenue remaining in the state Special Canine Research and Education Account does not revert to the state General Fund at the end of a fiscal year.

The bill annually appropriates all money deposited in the state Special Canine Research and Education Account during a state fiscal year to the Purdue University School of Veterinary Science and Medicine for its use in conducting canine disease research.

Farm Mutual Insurance Companies: This bill would allow farm mutual insurance companies to choose to

be taxed either under the Corporate AGI Tax or the Insurance Premium (IP) Tax. Currently, farm mutual insurance companies are only taxed under the Corporate AGI Tax. It is assumed that all farm mutual insurance companies would choose the tax treatment that would minimize their tax liability each year. There are currently 38 farm mutual insurance companies in the state.

It is estimated that this provision will decrease Corporate AGI Tax collections. If this bill had been effective in taxable year 2004, the loss in Corporate AGI Tax collections would have been approximately \$200,000, and the gain in Insurance Premium Tax collections would be approximately \$85,000, resulting in a net loss of \$115,000 in state revenues.

The corporate AGI Tax rate is 8.5%, and the IP Tax rate is 1.3% on gross premiums received on policies covering risks in the state. Revenue from the corporate AGI Tax and the IP Tax is distributed to the state General Fund.

Explanation of Local Expenditures: ***Taxpayer Notifications-Budget Estimates:*** Currently, a political subdivision must publish notice of tax levies, tax rates, and budget. Under the proposal, the county auditor must mail to each taxpayer a statement containing certain information pertaining to property taxes for the following year including: the taxpayer's AV, deductions, and credits; the estimated taxes that will be due from the taxpayer for each taxing unit; the corresponding tax liabilities for the current year; information on public hearings on the levies, tax rates, and budgets, and the opportunity to appeal the taxpayer's assessment.

This provision will increase expenses for the counties. The impact will depend on current practices and the extent of the information that counties currently distribute to taxpayers. There could be as many as 3.5 million taxpayers that would need to be notified by mail. If an additional mailing were required for each taxpayer at a cost of \$0.39 per taxpayer, costs could equal as much as \$1.4 M. If printing costs equaled \$0.07 per page per taxpayer, counties would incur an additional \$245,000 in mailing and expenses. Counties would also have additional personnel expenses for printing and handling the notices.

County auditors would also have to calculate estimated tax rates and estimated taxes for each taxpayer. Counties could incur additional computer programming costs to produce these estimates. The bill requires the DLGF to assist county auditors in preparing the statements.

Taxpayer Notifications-Tax Bills: Under current law, the county treasurer must send a tax statement to either the taxpayer or to the taxpayer's mortgage company if the mortgage company maintains an escrow account for property tax payments. The county treasurer may include in the statement an itemized listing for each levy, including the tax rate, the entity levying the tax, and the dollar amount of the tax owed. The treasurer may also include information regarding the manner in which the taxes are to be used.

Current law also contains a pilot program in selected counties that will become a statewide requirement in 2008 to provide additional statement information to all taxpayers, regardless of whether the tax bill is sent to the taxpayer's mortgage company. The additional information includes:

- (1) A breakdown of property taxes that will be distributed to each taxing unit;
- (2) A comparison showing any change in the property's AV from the previous year;
- (3) A comparison showing any change in the property tax liability from the previous year including the current and previous year liability attributable to each taxing unit and the percentage change in each;

- (4) An explanation of, and filing requirements for, the homestead credit, property tax deductions, and appeals procedures; and
- (5) A checklist that shows the homestead credit and all property tax deductions, and whether the homestead credit and each property tax deduction applies in the current statement.

Under the proposal, beginning with taxes payable in 2008, the county treasurer must mail to both the taxpayer and to the taxpayer's mortgage company a statement including all of the current required and optional information. Under this provision, the DLGF, subject to State Board of Accounts approval, would prescribe the form to be used. The proposed requirements that (1) provide the added information (rather than just the billing information) to mortgage companies and (2) include currently optional information (itemized listing of levies and rates, and tax usage information) in all statements could add to the expense of providing the new statements.

Petition and Remonstrances: The bill would restrict taxing units from using their resources to promote a bond or lease after the initial adoption of the ordinance or resolution to issue a bond or enter into a lease. Currently, this prohibition only applies during the remonstrance process. It would also restrict schools from using students in any way to promote a position on a project, and school staff may not personally identify a student as a child of a parent in support or opposition to a petition or remonstrance. The bill would prohibit a taxing unit from compelling an employee to promote a position on the petition or remonstrance. Persons that have a contract or arrangement with a school corporation for the use of facilities would be prohibited from spending money to promote a position.

Background: The DLGF approved about 106 school lease rentals or bond issues totaling about \$2.2 B for CY 2004 and CY 2005. School lease rentals or bond issues that have been subjected to the current petition and remonstrance process have been won by schools about 50% of the time. Many times the unsuccessful project was modified and then was successful.

Jasper County CAGIT: The bill would permit the Jasper County Council by ordinance to increase their CAGIT rate by 0.15%, 0.20%, or 0.25% for capital expenditures and operation/maintenance of their correctional facilities. However, the increase would be limited to the amount of revenue generated by a rate that is equal to the capital, operational, and maintenance jail expenditures incurred by Jasper County. After retirement of all bonds and leases, the county would be allowed to maintain a jail rate that does not exceed the costs to operate and maintain their jail facilities. The county would be allowed to maintain the jail rate for maintenance and operations until rescinded by ordinance.

Scott County COIT: Scott County would use additional revenue generated by a rate increase in COIT to finance, construct, acquire, improve, renovate, equip, maintain, or operate their county jail. The county treasurer would establish a county jail revenue fund for the receipt of the additional revenue.

Dog Tax: Under existing law, township assessors must take a census of the dogs in the township and collect the Dog Tax. All money derived by the Dog Tax must be used for the payment of damages sustained by owners of certain stock, fowl, or game killed, maimed, or damaged by dogs. Townships forward to the county at the end of a year any funds in a township dog fund exceeding \$300 over and above orders drawn on the fund.

Funds transferred to counties are deposited in the county dog fund. Money in the county dog fund is distributed among the townships or to humane societies. If the funds are insufficient to pay for damaged stock, fowl, and game, the losses are paid from the State Dog Account. Surplus remaining in the county dog fund is paid to the

Auditor of State and placed in a separate account of the state General Fund known as the State Dog Account. All money in excess of \$50,000 remaining in the State Dog Account after annual distributions are distributed to Purdue University for the School of Veterinary Science and Medicine and to the general fund of each county. As of January 13, 2006, the State Dog Account had a balance of \$48,864.

The bill repeals IC 15-5-9, which governs the responsibility of administering the Dog Tax and Dog Fund, including the payment of claims made against the fund for dog-related damages.

Collection of a County Option Dog Tax: The fiscal body of a county may collect a county option dog tax by any combination of the following methods: (1) by designating one or more persons in the county to collect the tax; (2) by requiring a person who harbors or keeps a taxable dog to submit a complete and accurate county option dog tax return; and (3) by a method other than a method described in (1) or (2) as determined by the fiscal body of the county. This provision of the bill would likely result in additional administrative costs for counties choosing to adopt a county option dog tax; however, actual costs are unknown and would be dependent on administrative action.

County Reimbursement of Dog Kill Claims: Counties would still be responsible for payment of claims submitted by persons for damages, less compensation by insurance or otherwise, sustained by owners for specific stock, fowl, or game killed, maimed, or damaged by a dog; and for paying for the expense of rabies post exposure prophylaxis that is incurred by any person who is bitten by or exposed to a dog known to have rabies. During FY 2005, claims paid from the Dog Fund totaled \$63,182. An additional \$28,211 in claims are unpaid at this time.

The bill requires county auditors to establish procedures and create forms for the submission of claims. County auditors would also be required to verify claims and issue reimbursement to approved persons.

Explanation of Local Revenues: Standard Homestead Deduction: This provision would increase the current \$35,000 standard deduction for homeowners by \$10,000 to a total of \$45,000 for property taxes payable in 2007.

The initial adjustment for trending will be effective for taxes payable in 2007 under current law producing an estimated 28% statewide increase in homestead gross assessed value. This bill would increase the standard deduction by a similar amount for taxes payable in 2007.

The statewide total standard deduction for taxes paid in 2005 was \$49.7 B AV. The total standard deduction in 2007 is estimated at \$52.4 B under current law. Under this proposal, the \$45,000 standard deduction would total an estimated \$63.8 B, for an increase of \$11.4 B. The additional standard deduction amount would cause a shift in part of the property tax burden from homesteads to all property, estimated at about \$100 M in CY 2007.

Credit for Excessive Residential Property Tax: Under current law, counties may provide credits against the property tax liability of residential property if the net property tax on the property, after all other credits are applied, exceeds 2% of the property's gross assessed value. The credit equals the amount of tax that exceeds the 2% threshold. At the county's discretion, residential property may include any combination of homesteads, apartment complexes, and other residential rental property. No application is required to receive the credit. The county auditor must identify the eligible property and apply the credit.

Under this bill:

1. The credit would be mandatory in Lake County in 2007. It would apply to all residential property in 2007 unless the Lake County Council adopts an ordinance by December 31, 2006, limiting the credit to only homesteads.
2. The credit would be mandatory in all counties for taxes payable in 2008 and in 2009. The credit would apply to all forms of residential property – homesteads, apartment complexes, and other residential rental property – in all counties. Counties would no longer have the option of choosing the type of residential property covered by the credit.
3. Beginning with taxes payable in 2010, the credit would apply to all real and personal property in all counties.

Credit Funding: Currently, counties are permitted to borrow money for a term of up to 5 years to pay for the credits. If the county borrows money in order to fund the credit, the civil taxing units and school corporations in the county are required to repay the loan and must impose a property tax levy to repay the debt. This levy is subject to the unit's maximum permissible levy limit and cannot be the basis for obtaining an excessive levy. If the property tax credits are granted, but not funded through a loan or other revenue source, the credits effectively reduce the tax collections that are distributed to local civil taxing units and school corporations with no replacement. So, if the county does not fund the credits, the entire cost of the credit is a local revenue reduction in the year granted.

Under this bill, beginning with taxes paid in 2007, counties would not be permitted to borrow money to fund the credit. The credits would reduce revenues for local civil taxing units and school corporations in affected counties.

The following are estimates of the potential cost of the credit in **2003** had the various credit policies been in effect in that year. Because of changes in assessments and levies, the credits in 2007 and later years may not resemble these amounts.

Homesteads: An analysis of **2003** parcel-level tax data indicates that there were 37 counties with at least one homestead that could qualify for the credit. Of those, only 13 counties had more than five qualifying homesteads. There are two counties, Lake and St. Joseph, where the credit for homesteads would be of any real significance at 31,800 and 3,000 credits, respectively. Also of note are Delaware (273) and Vigo (419) Counties. The total of all potential credits on homesteads in 2003 was \$18.7 M. The notable counties are Lake (\$16.9 M), St. Joseph (\$1.5 M), Delaware (\$106,000), and Vigo (\$127,000). Lake and St. Joseph Counties make up the bulk of the potential 2003 credit at \$18.4 M. *The actual 2005 Lake County credit for homesteads amounted to \$13.4 M.*

All Residential Property: An analysis of **2003** parcel-level tax data indicates that there were 60 counties with qualifying residential property (homesteads, apartment complexes, and other residential rental property) that could qualify for the credit. The total of potential credits on all residential property in 2003 was \$127 M. The notable counties are Lake (\$64.0 M), Marion (\$21.0 M), and St. Joseph (\$19.5 M). Lake, Marion, and St. Joseph Counties account for the majority of the potential 2003 credit at \$104.5 M.

All Real Property: An analysis of **2003** parcel-level tax data indicates that there were 61 counties with qualifying real property of any type that could qualify for the credit. The total of potential credits on all real property in 2003 was \$291 M. The notable counties are Lake (\$135.9 M), Marion (\$55.3 M), and St. Joseph (\$44.7 M). Lake, Marion, and St. Joseph Counties account for the majority of the potential 2003 credit at

\$235.9 M.

Personal Property: An analysis of **2005** county abstract data indicates that the total of potential credits on all personal property in 2005 was at least \$218 M in 88 counties. The notable counties are Lake (\$82.3 M), Marion (\$33.3 M), and St. Joseph (\$19.3 M).

All Real and Personal Property: A combination of the **2003** real and **2005** personal property analyses indicates that the total of potential credits on all real and personal property could total \$509 M. The notable counties are Lake (\$218.2 M), Marion (\$88.6 M), and St. Joseph (\$64.0 M). These counties account for the majority of the potential credit at \$370.8 M.

As a result of changing levies and tax rates, assessment adjustments, and more expensive new homes, the number and cost of the credits changes each year. In 2007, annual real property AV adjustments (trending) and the elimination of the remaining inventory AV are set to become effective. In most cases, gross AV will increase and the tax rate will be reduced. The number and cost of the credits in 2007 depend on (1) the types of property included by each county, (2) changes in the assessed value of real property, and (3) changes in tax rates.

2006 Credit: Currently, a county that wishes to provide local property tax credits for residential property must adopt an ordinance allowing the credit by June 30th of the year before the year in which the taxes are payable. This bill would allow counties to adopt an ordinance to allow the credit against taxes paid in 2006 at any time before the 2006 tax bills are issued. The fiscal impact of the 2006 credit provision is fully dependent on local action.

Jasper County CAGIT: Under the bill, Jasper County would be authorized to maintain a combined CAGIT and County Economic Development Income Tax (CEDIT) rate not exceeding 1.5% (with exception for any additional CEDIT rate adopted for homesteads). Under current law, with a few exceptions, the maximum combined rate of CAGIT and CEDIT is 1.25%.

If a 0.25% rate increase were effective on July 1, 2006, the additional rate is estimated to generate approximately \$1.41 M in CY 2007, \$1.45 M in CY 2008, and \$1.5 M in CY 2009 for jail operation and maintenance.

Background: Jasper County currently imposes CAGIT at a 1.00% rate and will receive a CY 2006 certified distribution of \$5.43 M.

Scott County COIT: Under the bill, Scott County would be authorized to maintain a combined COIT and CEDIT rate not exceeding 1.25% (with exception for any additional CEDIT rate adopted for homesteads). Under current law, with a few exceptions, the maximum combined rate of COIT and CEDIT is 1.00%.

If the Scott County Council determines that additional COIT revenue is needed to fund jail improvement capital projects, the Council would be allowed to increase the county's COIT rate by no more than 0.25% under this provision.

If an ordinance to increase the rate were adopted by the Council before June 1, 2006, or before April 1 of a subsequent year, the additional rate would be effective on July 1 in the year of adoption. If the ordinance were adopted after May 31, 2006, or after March 31, of a subsequent year, the rate would be effective July 1 in the

year following the year of adoption.

In either adoption scenario, Scott County would begin to receive revenue from the tax in the immediately following year. Therefore, if Scott County were to adopt the additional COIT rate in CY 2006, the county would begin to receive revenue from the rate increase in January 2007.

If a 0.25% rate increase were effective on July 1, 2006, the additional rate is estimated to generate approximately \$0.82 M in CY 2007, \$0.85 M in CY 2008, and \$0.87 M in CY 2009. All revenue generated by an additional tax rate would be set aside for the jail before the certified distribution is divided between the civil taxing units in the County.

Background: Scott County received a certified COIT distribution of \$3.2 M in CY 2006 at a 1.00% rate. The county also received a certified CEDIT distribution of \$0.48 M in CY 2006 at a 0.16% rate.

County Residential Tax Relief: Under current law, counties are permitted to use CEDIT proceeds to pay for additional homestead credits in the county in order to mitigate all or part of any shift of the tax burden from inventory property to homestead property caused by the 100% inventory deduction. The county may impose an additional CEDIT rate of up to 0.25% for this purpose. This bill would permit the county to offer the credit either to homesteads or to all property that is used as residential, including mobile homes and commercial apartments. There would be no change to the additional 0.25% CEDIT rate.

The bill also extends the deadline in 2006 by which an ordinance can be adopted from March 31, 2006, to May 31, 2006.

If (1) the credit is offered to non-homestead residential units as well as homesteads as allowed under this provision and (2) the county has not already imposed the maximum CEDIT tax rate, then the county could, at its discretion, increase the CEDIT tax rate (within the current local option income tax rate limitations) to fund the additional credits. The impact depends on local action.

Dog Tax: Under the bill, counties would no longer receive Dog Tax revenue from the townships. However, counties that forwarded surplus Dog Tax money to the state would receive 50% of the money remaining in the State Dog Tax Fund on May 1, 2006. The amount that the counties would receive would be in proportion to what each county forwarded to the state relative to all other counties. As of January 13, 2006, the state account contained \$48,864. If the May 1, 2006, balance is comparable, about \$25,000 would be distributed among the eligible counties. Under the proposal, counties would be required to distribute this revenue in equal shares to all the townships in the county. The township must deposit the money in the township dog fund which is abolished. The money must be distributed to pay for claims, fees and charges, humane societies, and the township general fund.

If the township trustee has not distributed the money by July 1, 2007, for one of the aforementioned purposes, the township trustee is then required to distribute the remainder of the distribution received to the county treasurer. If the County Option Dog Tax is in effect in the county on July 1, 2007, the county treasurer is required to deposit the money into the County Option Dog Tax Fund. Under the bill, none of the money could then be allocated to the County Canine Research and Education Account. If the County Option Dog Tax is not in effect in the county on July 1, 2007, the county treasurer is required to deposit the money in the county general fund.

Additionally, for each individual dog tag or kennel license issued, the township assessor (or trustee who collects the fee) retains an administrative fee of \$0.50. Administrative fees collected by the assessor are deposited in the county general fund, and administrative fees collected by the trustee are deposited in the township general fund. Repealing the Dog Tax will decrease revenue in the township funds.

County Option Dog Tax: This bill allows the fiscal body of a county to adopt an ordinance to impose a tax on dogs at least 6 months of age that a person harbors or keeps in or near the person's premises in the county. Money derived from the tax, less any fees, is to be deposited in the county option dog tax fund. A tax imposed may not exceed \$5 per year for each dog subject to the tax. The bill establishes a maximum amount of county option dog tax that may be imposed per year for dogs kept in kennels for breeding, boarding, or training purposes or for sale. The maximum amount would be equal to the lesser of the total amount of county option dog tax calculated, or for a kennel consisting of: (a) more than 6 dogs at least 6 months of age, \$50, or (b) not more than 6 dogs at least 6 months of age, \$30.

The American Veterinary Medical Association reports that there are approximately 1.2 million dogs in the state. If each of these animal's owners were to remit the county option dog tax, revenue could equal up to \$6 M annually. However, the amount would be reduced by the number of kennels paying less than \$5 per dog at least 6 months of age. The number of kennels consisting of more than or less than 6 dogs is not known. As a result, actual increase in revenues is indeterminable.

The bill requires a county treasurer to establish a county option dog tax fund if the county fiscal body has adopted a county option dog tax. The county treasurer must also establish a canine research and education account within the county option dog tax fund. Interest and investment income derived from money in a county option dog tax fund becomes part of the county option dog tax fund. Money in a county's county option dog tax fund does not revert to the county's general fund at the end of a calendar year. Twenty percent of money deposited in the county option dog tax fund is to be deposited in the county canine research and education account. The remaining 80% is to be designated for uses determined by the county fiscal body. Under the bill, counties would be allowed to appropriate the aforementioned 80% of funds to animal care facilities, for expenses associated with the pickup and disposal of dead animals, to reimburse farmers for livestock kills, and to reimburse people who have undergone rabies post exposure prophylaxis.

Additionally, if a county fiscal body has appointed one or more persons to collect the county option dog tax, the person or persons may retain an administrative fee not to exceed \$0.75 from the amount collected for each taxable dog. Fees retained would then be remitted to the county treasurer.

Tuition Support: State Revenue: The bill increases the maximum tuition support distribution for CY 2006 to schools to the greater of \$3,802,900,000 or the amount sufficient such that the Department of Education would not be required to make a reduction in tuition support in the last six months of CY 2006.

School General Fund Property Tax Levies: The bill would use the lesser of the 2006 or the 2007 AV in the school formula calculation of the school general fund maximum levy for 2007 instead of the 2007 AV. The DLGF may increase the foundation tax rate in the school formula calculations if the difference in the levy between the lesser of \$2,035.9 M or a 4.1% increase of the 2006 maximum levy minus the 2007 maximum levy is greater than \$1 M. Before the foundation tax rate is increased, the DLGF must review the recommendations with the Department of Education and the Budget Agency.

The bill also allows the Department of Education to develop alternative calculations of the 2007 school formula

levy if the Department determines the current calculations will adversely affect the policy of taxpayer equalization as a result of the effects of the annual adjustment or other factors in 2007. The alternative calculation should more closely comply with the taxpayer tax equalization policies embodied in the 2007 school formula. After review by the Budget Committee and approval by the Budget Agency, the DLGF would adjust 2007 general fund maximum levies to implement the alternative calculations.

State Agencies Affected: Department of Local Government Finance; Department of Education; Department of State Revenue; State Budget Agency.

Local Agencies Affected: Civil taxing units and school corporations; County auditors; County treasurers; Jasper County; Scott County.

Information Sources: Local Government Database; County parcel-level real property assessment records; County auditor's abstracts; DLGF; *Indiana Handbook of Taxes, Revenues, and Appropriations*; State Budget Agency.

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